

HOUSE FINANCE COMMITTEE
January 27, 2015
1:30 p.m.

1:30:47 PM

CALL TO ORDER

Co-Chair Neuman called the House Finance Committee meeting to order at 1:30 p.m.

MEMBERS PRESENT

Representative Mark Neuman, Co-Chair
Representative Steve Thompson, Co-Chair
Representative Dan Saddler, Vice-Chair
Representative Bryce Edgmon
Representative Les Gara
Representative Lynn Gattis
Representative David Guttenberg
Representative Scott Kawasaki
Representative Cathy Munoz
Representative Lance Pruitt
Representative Tammie Wilson

MEMBERS ABSENT

None

ALSO PRESENT

RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE; John Tichotsky, Chief Economist, Tax Division, Department of Revenue; Dan Stickel, Assistant Chief Economist, Tax Division, Department of Revenue. Jerry Burnett, Deputy Commissioner, Treasury Division, Department of Revenue.

PRESENT VIA TELECONFERENCE

Lennie Dees, Audit Master, Tax Division, Department of Revenue.

SUMMARY

REVENUE FORECAST and OIL and GAS TAX CREDITS

FY 16 BUDGET OVERVIEW: DEPARTMENT OF REVENUE

Co-Chair Neuman reviewed the agenda for the day.

[1:31:23 PM](#)

^REVENUE FORECAST: DEPARTMENT OF REVENUE

[1:31:53 PM](#)

RANDALL HOFFBECK, COMMISSIONER, DEPARTMENT OF REVENUE, introduced the PowerPoint presentation "Revenue Forecast" (copy on file). The focus of the presentation would be on the "How" and the "Why" of the revenue forecast. He would be addressing how the revenue forecast was done and why certain assumptions were made. There had been significant concern about the tumbling oil prices and whether the forecast remained reasonable. He relayed that Dr. Tichotsky would be doing much of the presentation since his group put together the forecast and was responsible for producing the Revenue Sources Book.

Co-Chair Neuman reminded committee members to be conscious of time and to keep questions in line with the topic. He encouraged members to ask questions.

Commissioner Hoffbeck began with slide 3: "Methods: What Do We Forecast at DOR?" The primary focus of the department's forecast was petroleum revenue and secondarily non-petroleum revenue. Since petroleum revenue was Alaska's largest income component, it would receive the bulk of attention. Petroleum revenues including production taxes, severance tax, royalties, corporate income tax, and other oil-related taxes such as property taxes, and non-petroleum revenues made up one bucket of money. The second bucket of money was composed of investment revenues, the forecast of which was produced by the state's investment advisors, Callen. The forecast largely reflected long-term trends with some adjustments for market conditions. The third bucket of money was comprised of federal revenues to the state. The department forecasted what was actually authorized for spending. Typically, the actual revenues received were 20 to 30 percent less due to the state not meeting all of the match requirements. The three buckets of money were what was compiled into the Revenue Sources Book.

Commissioner Hoffbeck moved on to slide 4: "Oil Revenue Forecasting." The slide reflected the way in which the

forecast was put together. He pointed to the formula about one-third of the way down the page that read "Net value equals, price multiplied by production, minus costs". The three areas he would be looking at that made up the state's net value were price, production, and cost. The revenue forecast would then be built by taking the net value multiplied by the tax rate and then deducting credits taken against liability. The department would provide a separate presentation on credits.

Commissioner Hoffbeck advanced to slide 5: "Fall 2014 Highlights." He indicated there had been some concern about the change between the spring forecast and the fall forecast and the significant changes in how the forecast was put together. The assumptions, the methodologies, and the people that made the forecast were the same. The main difference was the oil price. There was also some adjustment for oil production. The department had seen a slight uptick in production, information that had become available in between the spring and fall forecasts. There had been additional investment and production.

[1:36:46 PM](#)

JOHN TICHOTSKY, CHIEF ECONOMIST, TAX DIVISION, DEPARTMENT OF REVENUE, began with slide 7: "Production History and Forecast." He indicated that he would provide a larger view of production giving a history of production and forecasting and how an increased forecast fit into a broader picture in order to put things into perspective. He enjoyed the longer-term view.

Co-Chair Neuman asked about slide 7. He wondered if the forecast included estimates on future production due to investments in current production tax credits for new investments.

Mr. Tichotsky specified that Co-Chair Neuman was correct. He explained that the methodology was such that every October the department interviewed almost every active company including the exploration companies, companies that were planning to produce. The department summarized the information in addition to modeling currently producing fields and wells. Department of Revenue came up with an overall production forecast. The slight uptick on the slide reflected what people were reading in the press about additional production. However, because of the criteria the

department used to include the production in its forecast, production was not booked until there was confirmation that it was included in the business plans of the companies.

Co-Chair Neuman asked if Mr. Tichotsky had an estimate if a gas pipeline was in operation by 2023.

Mr. Tichotsky responded that the chart reflected oil production. He reported that one of the issues that the department encountered was that most of the information it received was good for 3 to 5 years. Beyond 5 years companies had a difficulty seeing far out into the future. The decline seen on the slide was a function of a physical decline and of the state's certainty. The state believed that for 2023 the estimate would be approximately 300 thousand barrels of oil per day. The department believed that the estimate had a wide range of variance on its estimate. He furthered that if he was asked about the forecast in 2023 he would respond 300 thousand barrels per day plus or minus 300 thousand barrels. Whereas, in the following year he could say with relative certainty within tens of thousands of barrels what would likely be produced. The department had been extremely accurate since adjusting its methodology. Certainly 1 to 2 years out there would be great certainty. In the slides provided a point estimate was provided and showed some of the ranges of possibilities in the future.

[1:40:31 PM](#)

Representative Gara asked about the top color on the chart. He wondered if the color in 2015 represented offshore oil. Mr. Tichotsky responded that the top skin came in from Prudhoe Bay to the right to Endicott then were added from Kuparuk which satellited to Point Thomson. They layered in as reflected in the legend.

Representative Gara responded that his chart showed a light green for the top layer that appeared to be getting wider in 2015. He wondered if it reflected "Offshore". Mr. Tichotsky responded in the affirmative.

Representative Gara asked about the slight increase. He wondered if the state would receive any production tax if the oil production increased. He also asked about what offshore fields were represented in the "Offshore" category. Mr. Tichotsky responded that the offshore

category was not what many would considered part of the Outer Continental Shelf (OCS). The offshore category represented the zero to 3 miles offshore which the state exerted sovereignty. In addition the state had a revenue sharing provision from 3 mile to 6 mile range. The state had no sovereign jurisdiction beyond 6 miles. The offshore category represented only the oil within the state's jurisdiction.

Representative Gara asked Mr. Tichotsky to clarify what he considered to be the oil within the state's jurisdiction. Mr. Tichotsky answered that it reflected the oil between zero to 3 and 3 to 6 mile ranges.

Co-Chair Neuman commented that the state recently had entered into an agreement with Callos Energy regarding Marathon's Liberty Field investing \$1.2 billion. Mr. Tichotsky did not hear all of the details of Co-Chair Neuman's question. He asked Co-Chair Neuman to repeat his question.

Co-Chair Neuman stated that it was okay to wait until later to discuss his question. Mr. Tichotsky responded that it would include North Star, Oooguruk, and Liberty fields.

[1:43:07 PM](#)

Mr. Tichotsky advanced to slide 8: "ANS Production Comparison." He relayed that the slide showed the revision from the spring to the fall forecast. It included the additional information the department received in October. The time between the months of September and October was a critical time for the oil companies in terms of planning and providing information to the state. He pointed out the production increase from 2015 through 2017 or 2018 [Depicted in blue], during which time production remained above 500 thousand barrels per day. The decline rate was a function of the probability of being able to forecast the future. It was not necessarily DOR's belief that the production would decline at the rate shown.

Representative Wilson commented that production was close to what the state had thought it would be. She asked if the state's budget would have been close to being accurate had the price been close to what the state had predicted it would be at the end of the prior year. Mr. Tichotsky

responded that price was absolutely a major driver in determining revenue.

Representative Wilson wanted to clarify that it was price rather than production affecting state revenue. Mr. Tichotsky responded, "That is correct." The other issue was that investment decisions were made on a different time scale. The price environment collapsing was not necessarily connected to investment decisions. The production was driven largely from what information the state received regarding investment decisions.

Mr. Tichotsky pointed out that the Revenue Sources Book was a great summary of the information DOR was presenting. In addition, with the help of his staff, it was also the repository of data. He noted a new feature, the Quick Response (QR) codes, easily read by an application in a smart phone, which allowed a reader to see the data tables.

Mr. Tichotsky scrolled to slide 9: "ANS Oil Production Forecast." He asserted that the forecast was sorted into three major bins; developed or currently producing reserves, undeveloped reserves, and contingent reserves. The three categories of reserves added together equaled the state's unrisks investment case.

Mr. Tichotsky discussed slide 10: "Production Forecast." He relayed that in the graph the point estimate for 2015 and 2016 were provided. Going forward into 2017 the state would begin to risk the unrisks investment case. He explained that the unrisks investment case was everything the industry informed the state that it was likely to produce. The low investment case was a circumstance in which all currently producing wells were to continue producing with no further investment or additional wells brought on line. In reviewing the state's methodology two elements needed to be risked; the first was when a project was announced but delayed, and the second was when greater production was anticipated but targets were not reached. When the state did its risking it was not well specific or project specific. The state risked across the board. He believed it was a good strategy because he had found that on average the risks in criteria were useful. They got larger the further out in time they were due to uncertainty. They were also based on industry standards developed out of looking at some of the classic oil industry expectations chapters.

1:49:18 PM

Mr. Tichotsky pointed to slide 11: "Dept. of Revenue Investment Cases." He suggested that the slide described how the state looked at the vocabulary in terms of investments. There were three investment cases; an unrisks investment case, and adjusted expected investment case, and a low investment case.

Mr. Tichotsky continued with slide 12: "North Slope Production Forecast." He drew the committee's attention to the green, red, and blue skins. He explained that they represented the volumes from contingent, undeveloped, forward-shifted developed, or developed reserves which helped to define the state's production forecast. He reported that the other two skins [the purple and teal colored skins] represented the potential upside volumes. The economic research group favored seeing that the likely probability was that the volumes from the development reserves would fall between the two goal posts without any new unexpected discovery or a black swan event.

Representative Gattis stated that she thought she had heard Mr. Tichotsky say that throughput would fall somewhere between 500 thousand and 600 thousand barrels per day. She asked for clarification.

Mr. Tichotsky responded that the state's production forecast baseline was represented by the top of the green skin. However, production climbing to the top of the teal skin was not unrealistic based on information the state received from the industry concerning what was possible to produce and what was planned for production. Price and investment were also factors considered in forecasting. Reaching the top of the upside potential volumes from contingent resources was within the realm of possibility based on current technology and the status of infrastructure on the slope.

Vice-Chair Saddler asked whether Mr. Tichotsky had any formal or informal estimates of production from the 1002 area of the Arctic National Wildlife Refuge.

Mr. Tichotsky responded in the negative. He explained that it was not within the 10-year horizon. He added that there was an indication from United States Geological Survey that there were undiscovered reserves in the area and there was

an earlier evaluation conducted by DNR in 2009 indicating the same information. However, the information was limited. He emphasized that the data pointed to undiscovered resources rather than reserves.

Mr. Tichotsky advanced to slide 14: "Alaska North Slope Crude West Coast Price." He explained that when the department looked at prices its focus was to look at averages. The average price of the period was about \$104. It was clear that there was an event in which the price dropped dramatically by more than 50 percent within a short period of time.

Mr. Tichotsky explained slide 15: "Alaska North Slope Crude West Coast and West Texas Intermediate Prices." He reported that in looking at a longer term horizon back to 2007 the drop was not an unexpected event. Economists were very familiar with volatility over the long term. Price stability was something that Alaska enjoyed for several years but was an anomaly.

[1:54:08 PM](#)

Mr. Tichotsky moved on to slide 16: "Key Oil Price Drivers." There were two key oil price drivers that DOR monitored. The first was the global spare capacity of Oil Producing and Exporting Countries (OPEC) which included Saudi Arabia. The second factor was the cost of developing new oil supply. Currently, there was adequate supply in the market driving the price down. Also, at present, the global demand was weak and Saudi Arabia was willing to sustain lower prices in order to maintain its market share.

Mr. Tichotsky looked at slide 17: "Price Forecast Methodology." He relayed that on the first Tuesday of October DOR held a day-long oil price forecasting session. In the current year it occurred on the 7th of October. The State of Alaska was very fortunate to have its investment funds, particularly the Permanent Fund. The state had access to top-notch investment advisors. The state often invited quality presenters to speak to both the U.S. economy and the global economy. He remarked that people were very interested in discussing pricing in the price forecast session. In the past year there were 37 participants from state government, academia, and the private sector. Department of Revenue, Department of Natural Resources, Department of Law, the Office of

Management and Budget, and the Legislative Finance Division participated. There was a wide variety of people interested in markets or had expertise in the oil and gas industry. Rather than asking for a high, medium, low estimate approach the department asked for more statistical information. The general process that the department used was a modified Delphi approach. He explained that people were given information in which they were then able to incorporate throughout the day in order to present their opinion of the pricing at the end of the day. The opinions were then aggregated. In the current year at the price forecast session people were asked for a probability of 10, a probability of 90, and the median. The median price was then used to generate the point estimate used for the revenue. He advised the committee to keep in mind that DOR forecasted real prices. However, when DOR generated the revenue forecast it included inflation. Therefore, when looking at prices 10 years out the \$120 to \$130 per barrel range would equate to about \$90 to \$100 in current dollars.

1:57:33 PM

Representative Edgmon recalled in the previous year that the governor's 10-year budget had prices soaring into the \$120 to \$130 range. Mr. Tichotsky indicated it was a "no change" price. When prices sloped up with a 2.5 percent inflation rate it meant the current price was the same taking inflation into account.

Representative Edgmon asked about the process in which the department went through every October. He wondered if the meeting set the stage for looking 10 years out. Mr. Tichotsky responded affirmatively. Participants were asked to do the price forecast for a 10-year period.

Representative Gattis asked about whether the forecasting done in the prior October accounted for the downturn in oil pricing. Mr. Tichotsky explained that there were different views concerning supply and demand. He furthered that when prices were very high there would always be someone in the room that would predict that prices would drop. Often times psychologically it was a difficult thing to say because of current prices. The opposite was true in a low-price environment where someone might predict that prices would go up. Not everyone shared the same opinion.

Representative Gattis followed up with a questions about whether the financial crisis could have been forecasted. She suggested it was a guessing game of sorts. Mr. Tichotsky responded that, generally speaking, it was extremely difficult to forecast. He added that it was always a challenge to forecast a great change in direction. In other words, when something changed from one state to the next, psychologically human beings were resistant to understanding change. On the other hand economists were always ready to anticipate a change. Department of Revenue put the forecast out as one of the tools for legislators for budgeting purposes. The department also used the revenue forecast for other items such as when the state approached rating agencies.

2:00:45 PM

Mr. Tichotsky continued that when legislators were looking at the revenue forecast or the price and budgeted lower than the predicted revenue to be on the safe side, they looked at it from the standpoint of the glass being half empty. When approaching the credit rating agencies the glass was presented as being half full focusing on things such as capacity. The revenue forecast was strictly a tool.

Co-Chair Neuman reminded committee members and presenters about time constraints.

Mr. Tichotsky moved onto slide 18: "Fall 2014 ANS Revenue Forecast Prices." He discussed the methodology used in forecasting. He reported that DOR adapted when prices were low. The department had looked at being able to hybrid the information from the price forecast session. The price forecast was DOR's price forecast endorsed by the commissioner and was a recommendation. The department wanted to make sure it reflected reality in order to have a credible forecast in which to base decisions.

Mr. Tichotsky turned to slide 19: "What if the oil price is..." for the last half of FY 2015." He indicated that because the price of oil in the state was high in the early part of the current fiscal year, even if oil prices dropped to \$50 per barrel of oil, the price would average about \$70 per barrel over the course of the year.

Mr. Tichotsky discussed slide 20: "Historical ANS West Coast FY Oil Price Bands: Annual Average and Official

FY2014 Forecast." He pointed to the portion on the left that depicted actual oil prices. The dots indicated the average price and the black scale represented a range of prices including the highest and lowest prices for the corresponding year. The portion on the right of the slide represented the forecast which also showed a range of pricing possibilities in black and the specific price forecast in the Revenue Sources Book in dots. He explained that a revision would be provided prior to the end of the legislative session there was a revised view. He suggested that if the information was changed so might legislators' minds. One thing he stressed that for two years running in 2013 and 2014 the state had the exact same price to three decimal places. He commented that it reflected stability but it was also as if lightning struck 16 times in one place.

[2:04:37 PM](#)

Mr. Tichotsky looked at slide 22: "General Fund Unrestricted Oil Revenues." He indicated that one of the mainstays of petroleum revenue during times of low oil prices was the state's net royalty, the payment the state received as owners of the resource. The production tax and corporate income tax were highly dependent upon oil pricing whereas, property tax was not. Non-petroleum revenue equaled about \$500 million depending on the market. Revenue for 2015 was forecasted to be about half of the actual revenue for 2014.

Mr. Tichotsky reported on slide 23: "General Fund Unrestricted Revenues Non-Petroleum." He relayed that the slide provided an overview of the unrestricted non-petroleum revenues. He suggested that the \$500 million revenue detail could be found in the Revenue Sources Book.

Mr. Tichotsky scrolled to slide 24: "Total Revenue Forecast - FY 2015 and 2016." He mentioned that although the investment revenue was important it did not get deposited into the general fund (GF). The state continued to generate revenue off of its assets. The total state revenue for FY 14 was \$17 billion, the second largest state revenue figure. The state forecasted healthy total state revenues for FY 15 even in the face of lower total unrestricted revenue.

Mr. Tichotsky advanced to slide 25: "FY 2016 General Fund Unrestricted Revenue with Price Sensitivity." He reported that the department was frequently asked about what would happen if the price was higher or lower. He suggested that the graph on the slide was in the Revenue Sources Book and was a way to get a feel for what the revenue might be. He pointed out that if the price of oil was between \$80 and lower the revenue slope became flatter due to the minimum tax.

2:07:23 PM

Mr. Tichotsky reviewed slide 27: "Comparison - Fall 2014 vs. Spring 2014 Forecasts." He indicated that the price of oil had changed, which was the major driver for the changes from the spring to the fall forecast. There was a small increase in production from spring to fall. Overall there was a significant change to the general fund unrestricted revenue mainly due to the change in the price of oil.

Mr. Tichotsky continued with slide 28: "Contributors of Change in FY2015 Revenue Forecast." He reported that the slide reflected more of the same and suggested that the slide provided detail which might be useful in the future.

Mr. Tichotsky looked at slide 29: "Contributors of Change in FY2016 Revenue Forecast." He skipped through the slide indicating that the same applied for FY 2016.

Mr. Tichotsky moved to slide 30: "North Slope Capital Expenditure Forecast Change." He explained that DOR reviewed its capital expenditure forecast. The driver for increased production was that the state forecasted additional capital expenditures especially in near years.

Mr. Tichotsky viewed slide 31: "North Slope Operating Expenditure Forecast change." He relayed that operating expenditures were increased based on the increase in production.

Co-Chair Neuman asked how the slide showed increased investment since 2013.

Mr. Tichotsky referred back to slide 30. In the previous year there was an increase in investment, and based on the interviews going forward the department saw a relatively larger amount in the fall of 2014. The numbers on the

bottom of the slide were significantly larger especially in FY 16, FY 17, and FY 18. Looking out further to FY 19, FY 20, and FY 21 the years were of interest but less significant. The oil industry was providing the state with very forward looking statements about its plan.

Representative Edgmon asked whether the numbers were adjusted for inflation. Mr. Tichotsky responded that the numbers were nominal dollars.

Representative Edgmon expressed that it would be helpful to have non-adjusted numbers to do a comparative analysis. Mr. Tichotsky indicated that he would be happy to provide Representative Edgmon with the information and additionally would provide an inflation series.

Co-Chair Neuman asked that the information be provided to his office and he would make sure to disperse it to all committee members.

Representative Edgmon suggested including the information on the same graph. Mr. Tichotsky responded that he would be happy to reproduce the graphs in real and nominal terms. He believed that a real view was very useful.

Mr. Tichotsky revealed slide 32: "Net Tax Credits versus Production Tax." He mentioned that the information on the slide would be discussed in the following presentation.

Mr. Tichotsky discussed slide 33: "Fall 2014 Total Revenue Forecast." He indicated that in looking back at the total revenue history the state had experienced highly volatile revenues either because investment revenues and petroleum dollars were volatile. The state's non-petroleum dollars remained relatively steady. In looking forward it was difficult to anticipate volatility due to it being typically unexpected. On average, over a 10-year period DOR provided a fairly good picture.

[2:13:23 PM](#)

Vice-Chair Saddler noted the increase in federal spending in the out years compared to the historical data. He wondered why. Mr. Tichotsky responded that federal spending remained steady rather than increasing. Vice-Chair Saddler clarified that he was comparing it to the historical data. Mr. Tichotsky responded that it was a function of

forecasting. He referred back to the first slide that Commissioner Hoffbeck spoke about. The department forecasted a certain number but only received about 20 percent or 30 percent of the revenues that actually came in. He continued that out of the 3.1 that was allocated the state anticipated only receiving 2.5. He posed the question as to why the state did not discount upfront. It had been a tradition for DOR to use the allocated number.

Co-Chair Neuman asked to return to slide 32. He pointed to the red bars that fell below zero, production tax net of refundable credits, and commented that it was somewhat of an anomaly. He added that the refundable credits would sunset in 2016. He wondered if the state would see the red bar beyond 2016. Mr. Tichotsky responded that there were refundable credits that would extend beyond 2016. Some of the credits would sunset, but not all of them.

Co-Chair Neuman asked whether the refundable credits were for the smaller producers. Mr. Tichotsky replied that the refundable credits were primarily those claimed by explorers and those producers currently developing facilities that did not have any resulting revenues.

Co-Chair Neuman asked for clarity that Mr. Tichotsky was referring to smaller companies making new investments. Mr. Tichotsky responded in the affirmative. Co-Chair Neuman commented, "So we are cashing in using our production credits?" Mr. Tichotsky answered, "That is correct."

Co-Chair Neuman asked about the large producers. He referred to the darker green bars on slide 32. He wondered whether the bars indicated that the state was also competitive at low oil prices.

Commissioner Hoffbeck responded that whether the state was competitive at low oil prices the state still collected tax at low oil prices. He furthered that the difference between the light green and the dark green bars on the chart was the credits taken against tax liabilities. The state would collect about \$500 million in taxes from the producers in the current year even at low oil prices with the minimum tax in place.

Co-Chair Neuman asked whether the commissioner was only referring to the production taxes used by the larger

companies. Commissioner Hoffbeck replied, "This is generally the big three, yes."

Co-Chair Neuman was attempting to point out the difference the state saw for investments in tax credits between newer companies coming in in the red and the larger production tax credits that were investments for purchases from others used against tax liability by the big three. Mr. Tichotsky offered that Co-Chair Neuman was correct.

Representative Gara commented that the state had less revenue based on the two types of credits but suggested that there was a third place the state received less revenue. He continued that until the minimum floor was reached producers received a 35 percent tax deduction. He asked if he was correct. Commissioner Hoffbeck responded that Representative Gara was correct until the minimum floor was reached.

Representative Gara suggested that only some fields had the minimum tax floor. He wondered whether the 4 percent floor applied to the gross value reduction (GVR) fields, the post-2002 production units, and whether the 35 percent deduction applied. Mr. Tichotsky relayed that he would be addressing Representative Gara's question in the following presentation.

Representative Wilson asked a question regarding slide 33. She wondered about holding on to barrels until the price of oil increased. Mr. Tichotsky responded that energy companies were typically used to volatility and made decisions accordingly. He explained that depending on the direction of prices, if the price increased in a low-price environment, then there would be a stimulus to invest. There was also a delayed reaction at times. The state had seen an increase of investment currently which meant that there would be an increase in production and tax revenue in subsequent years. There was sometimes a disconnection between a price signal and activity.

Representative Wilson commented that she would store the oil until the price increased. Mr. Tichotsky responded that what she was proposing was a hedging activity in which a commodity would be held back. The types of decisions she was mentioning depended on timing and how long a commodity would have to be stored. Generally, when producing off of a large field, producing what was possible was preferred.

Representative Kawasaki asked about a nexus between price and production. He wondered what production level the state would have to see to come up with the same amount of money over future years if the state continued to see low oil prices.

2:21:11 PM

Mr. Tichotsky responded that the budgeting process and the revenues and expenditures were disconnected. He recognized that in recent years the state had spent or at least had enough revenue to cover its expenditures. Within the state's forecast period, depending on price, it was not unreasonable to have yearly revenues between \$2 billion and \$5 billion based on current levels of production and expenditures.

Mr. Tichotsky returned to Representative Wilson's question. He relayed that oil in the ground was not oil in the bank. Even if a barrel of oil is produced, sold for \$20, and deposited in the bank for a period of ten years, the state might be able to get as much oil as the oil price that appreciated. Once a natural resource was turned into money there were many things that could be done to get the same or equal value. It depended upon a risk calculation. In general, there was a risk of never producing oil that was left in the ground, a significant risk that petroleum producers as well as the state recognized.

Representative Wilson was concerned about revenues and thought the state and producers might be able to rebound faster by keeping some oil in the ground. She wondered if DOR took into consideration whether oil companies would produce as quickly when the price of oil was low as opposed to when the price was higher. Mr. Tichotsky responded that in general when a facility was producing oil it tried to maximize production. A production manager's job was to maximize production and minimize costs without price consideration. He suggested Representative Wilson discuss her question with the oil companies.

Commissioner Hoffbeck commented about moving forward in the next portion of the presentation.

^OIL and GAS PRODUCTION TAX CREDITS: DEPARTMENT OF REVENUE

2:25:48 PM

Commissioner Hoffbeck introduced the PowerPoint presentation "Credits (copy on file)." He relayed that he had the Assistant Chief Economist, Dan Stickel with him to answer questions if needed during the presentation. He explained that the presentation was a historical overview of tax credits and the point at which the state was at in the credit process. He indicated he would touch briefly on the expiring credits to better understand what the state would be dealing with in the future.

Commissioner Hoffbeck detailed slide 3: "History of Oil and Gas Tax Credits." He explained that the credit situation that the state was currently in was a product of four separate tax regimes within the last 10 years, each with their own particular focus and contributing to the available credits to be used by the producers, explorers, and the developers. He mentioned that the first "modern era" credits came during the Economic Limit Factor (ELF) regime under SB 185 [Legislation passed in 2003 - Short Title: Royalty Reduction on Certain Oil/Tax Cred]. He explained that the credit was a 20 percent to 40 percent credit for exploration depending on type and location. The credit could be taken against a tax liability, sold to someone else with a tax liability, or carried forward. However, it could not be cashed in with the state. It was not a reimbursable credit, rather, it was to be used against someone's tax liability.

Commissioner Hoffbeck turned to slide 4: "History of Oil and Gas Tax Credits." Several credits were added with the passage of the Petroleum Profits Tax (PPT) [HB 3001 was legislation that passed in 2006 - Short Title: Oil/Gas Prod. Tax] moving from a gross tax to a net tax. There was a 20 percent loss carry forward credit. The 20 percent credit had changed over time multiple instances. There was also a 20 percent qualified capital expenditure that expired with SB 21 [Legislation which passed in 2013 that had to do with an oil and gas production tax]. There was also a small producer and new area tax credit. He furthered that the credit equaled \$6 million for frontier explorers and \$12 million for small producers. The credit expired in 2016 but had a 9 year tail which necessitated the state paying the credit for up to an additional 9 years. Another credit that was added with the passage of PPT was the transitional expenditure credit which expired in 2013.

Also, there was a mechanism for the state to buy back credits from small producers that produced less than 50 thousand barrels per day with a cap of \$25 million per year.

Co-Chair Neuman asked how many small producers took advantage of the credit. Commissioner Hoffbeck did not know but could provide the committee the numbers.

Representative Munoz asked about the liability on the 9-year tail. Commissioner Hoffbeck deferred to Mr. Stickel.

DAN STICKEL, ASSISTANT CHIEF ECONOMIST, TAX DIVISION, DEPARTMENT OF REVENUE, responded that the small producer credit was a credit of up to \$12 million per year per producer for the first 9 years of production. The forecast for the credits was between \$55 million and \$73 million per year for all of the companies involved. His numbers were based on the forecast for the following 4 years.

Vice-Chair Saddler asked for clarification about the \$55 million to \$73 million. Mr. Stickel specified that he was talking about the small producer credits. He continued that for FY 15 and FY 16 the department was estimating \$55 million for North Slope small producer credits and another \$12 million for non-North Slope producer credits. He reported that it would be a total of \$67 million for FY 15 and for FY 16 and \$85 total in FY 18. He relayed that the department had a document that provided additional details on the credits information included in the Revenue Sources Book. For the following 2 years the department was looking at about \$67 million in total small producer credits and increasing to \$85 million.

[2:31:53 PM](#)

Slide 5: "History of Oil and Gas Tax Credits." Commissioner Hoffbeck discussed the credits modified with Alaska's Clear and Equitable Share (ACES) [HB2001 was legislation passed in 2007 - Short Title: Oil and Gas Tax Amendments]. Alaska's Clear and Equitable Share (ACES) provided minor changes to the credits themselves. The loss carry forward was increased to 25 percent, eliminated the \$25 million cap on the small producer credit, and created the Tax Credit Fund, a sub fund of the GF.

Commissioner Hoffbeck advanced to slide 6: "History of Oil and Gas Tax Credits." He explained that between ACES and the SB 21 regime there were several Cook Inlet changes that were made to the tax credits in an effort to stimulate exploration and production in Southcentral Alaska. There was a gas storage facility credit that allowed for a storage facility to deal with peak demand times during brown-out conditions in Anchorage and the surrounding areas. The credit was granted to the first facility which was claimed in FY 14 in the amount of \$15 million. There was also a \$15 million credit available for a Liquefied Natural Gas (LNG) project that had not been claimed. He anticipated the credit would be claimed within the following 2 years.

Co-Chair Neuman asked whether the credits were for drilling dry wells. Commissioner Hoffbeck asked for Co-Chair Neuman to clarify whether he was referring to the gas storage facility credit. Co-Chair Neuman commented that he was not talking about the gas storage credit but the expenditure credit. Commissioner Hoffbeck commented that he hoped they were not for drilling dry wells.

Commissioner Hoffbeck continued to explain additional Cook Inlet credits. He mentioned a 40 percent well lease expenditure credit and remarked that it was for "Middle Earth" as well as Cook Inlet; anything South of the North Slope. Another credit was a jack-up rig credit put in place to encourage a jack-up rig in the north. Two rigs actually came north. The credit was 100 percent for the first well drilled up to \$25 million, 90 percent for the second well up to \$22.5 million, and 80 percent for the third well up to \$20 million. At present no producer had made a claim.

Co-Chair Neuman asked if any gas had been found. Commissioner Hoffbeck reported that the wells had been drilled but that there were information requirements associated with the credit. Therefore, some companies chose to use other credits with lesser returns.

Co-Chair Neuman commented that the state had offered a significant amount of credits without getting any gas. Commissioner Hoffbeck acknowledged that the state had learned of some information without having to pay any credits. The last credit on the slide he addressed was the frontier areas credit was set up in a fashion similar to the LNG storage and the jack-up rig credits. He anticipated

that the credits would be claimed in the Nenana and Susitna basins.

2:35:09 PM

Commissioner Hoffbeck pointed to slide 7: "History of Oil and Gas tax Credits." He conveyed that additional credit modifications came with the passing of legislation, SB 21 [Legislation passed in 2013 - Short Title: Oil and Gas Production Tax]. He summarized that SB 21 eliminated the 20 percent qualified capital credit only for the North Slope. The credit remained in place for Cook Inlet. The legislation also created a per-barrel credit which was essentially an offset against the 20 percent capital credit. They were not exactly the same but were a trade-off between the two credits. He furthered that the per barrel credit was an \$8 credit at \$80 per barrel of oil, a \$7 credit at \$90 per barrel of oil, and a \$6 credit at \$100 per barrel of oil. Once the price of oil reached \$150 per barrel of oil the credit no longer existed. In regards to new oil there was a \$5 flat credit for each barrel. He stated that the final piece within SB 21 was an increase of the loss carry forward credit to 35 percent. He explained that it was actually at 45 percent for the first two years during the transition period then dropped down to 35 percent in 2016. Cook Inlet remained at 25 percent for the net operating loss carry-forward credit. Cook Inlet was basically still under ACES. The change within SB 21 applied to the North Slope.

Co-Chair Neuman commented that it was probably too early to determine the original effects. He wondered whether the incentives were resulting in more production. Commissioner Hoffbeck responded that the state was seeing a substantial response in Cook Inlet. He indicated there was sufficient gas to ensure Southcentral would not run out. There was enough gas for other uses as well. The totality of the response in Cook Inlet in relationship to the cost of the credits was still to be determined.

Representative Gara asked whether the per-barrel credit had anything to do with how much oil was produced. He wondered if at different prices a different tax rate was paid. He supposed that it would max out at a 35 percent tax rate around \$160 per barrel, 20 percent at \$110 per barrel, and lower at lower oil prices. He asked if he was correct. Commissioner Hoffbeck affirmed that Representative Gara was

correct except that it was at \$150 rather than \$160 per barrel. It was not a production driven credit. The price credit was on every barrel produced.

Commissioner Hoffbeck continued with slide 8: "So to sum all that up..." He reported that over the last 10 years the size and the applicability of the oil and gas tax credit had grown dramatically. The slide showed a graphic representation of two types of credits. The first was the credits used against tax liability and the second was refundable credits for which the state actually issued checks. Both types of credits had grown over time. He relayed that the credits purchased by the state peaked in 2011. Otherwise they had tracked parallel with oil prices. He pointed out that the credit liability had grown each year in relationship to revenues generated by the price of oil.

[2:39:41 PM](#)

Commissioner Hoffbeck revealed slide 9: "So to sum all that up... (Continued)." He emphasized that not all credits should be viewed as a cost. The 20 percent capital credit under ACES and the per barrel credit under SB21 were really part of the tax rate itself. They worked together to create the tax rate. He stated that although credits function independently from rate, a person would not have a total picture of their function without looking at them together. He added that particularly with the per barrel credit the department saw it as a deduction prior to revenue. It did not show up on the cost line but in reduced revenue.

Co-Chair Neuman added that capital credits were created to encourage a desired behavior in the industry. He asked the commissioner to further explain how the industry reacted.

Commissioner Hoffbeck pointed out that it was easy to explain the reaction in relationship to explorers and new development. By offering credits the state took on a substantial portion of the risk that accompanied exploration and new field development. It was done in order to make marginal fields more economic to develop. It was an investment in the future to have additional production. The per-barrel allowance was an attempt to make Alaska's tax system competitive with other tax regimes. It was aimed at the companies that were already producing to encourage additional investment.

Co-Chair Neuman remarked that there was an upside to investments in exploration which resulted in creating more jobs to search for more oil.

Representative Wilson asked who determined whether the credits were working. Commissioner Hoffbeck asked Representative Wilson to restate her question.

Representative Wilson asked about who determined whether the credits were effective in incentivizing exploration. She wondered what department was in charge of evaluating the effectiveness of the credits. Commissioner Hoffbeck responded that it was a combination of many of the agencies. One of the things that Governor Walker made clear was that he was taking a comprehensive look at credits to make a business decision moving forward. He suggested that it was too early to know the impact of SB 21.

[2:44:11 PM](#)

Representative Kawasaki asked about qualified capital credits. He wondered if the credits were used primarily for the investment in maintenance for existing infrastructure. He suggested that the Legislative Finance Division had a different opinion about what the qualified capital expenditure credit ended up accomplishing.

Commissioner Hoffbeck replied that the statement was not inaccurate. Much of the credits went towards infrastructure and maintenance which had some impact on continuing and increased production. The totality of the analysis was incomplete.

Representative Kawasaki asked when the ACES audit would be made public and available for review. Commissioner Hoffbeck asked whether Representative Kawasaki was referring to an independent company audit or a total audit of ACES.

Representative Kawasaki commented that the state had gone back and forth changing the system. It was changed with SB 21. His problem was that the state never fully examined whether ACES was working. He wanted to confirm that an audit was being done or was completed. Commissioner Hoffbeck reported that individual audits were being done on companies and that the first of the ACES audits would be released shortly. There was a 6 year statute limitation. He

furthered that he had been assured by his staff that the audit reports would be out before the statute limitation. He confirmed that PPT audits were completed and his staff was currently working on audits for ACES.

Commissioner Hoffbeck commented that slide 9 also touched on the fact that there had been increased activity.

Representative Munoz referred back to slide 8. She asked what portion of the \$1.2 billion in credits was attributable to Cook Inlet. Commissioner Hoffbeck responded that of the reimbursable credits approximately half were attributed to Cook Inlet and the other half were attributed to the North Slope. He detailed that 100 percent of the credits used against tax liability were assigned to the North Slope. About a quarter of the total credits were reimbursable to Cook Inlet.

Representative Gara asked about the bottom blue portion on the graph on slide 8. He commented that under SB 21 the blue part included a portion that was not credits, but a price per barrel credit. He asked if he was accurate. Commissioner Hoffbeck affirmed that it was essentially the per barrel allowance that was reflected in blue.

[2:48:19 PM](#)

Commissioner Hoffbeck presented slide 10: "Net Tax Credits versus Production Tax." Commissioner Hoffbeck indicated that the slide was a history look back to 2007 when the refundable credits were implemented. The light green bar reflected total production tax revenue prior to applying the credits. He continued that the dark green bar represented the production tax after credits were applied against liability. The red bar indicated the refundable credits. He pointed out that over time the red bar had grown dramatically. He added that the credits against liability had also grown particularly as a percentage of total revenue.

Vice-Chair Saddler asked the commissioner to define "refundable credits." Commissioner Hoffbeck answered that the refundable credits could be cashed in with the state. He added that companies that did not have a tax liability could essentially sell the credits back to the state.

Co-Chair Neuman asked if the credits could be other refundable credits that companies who had a tax liability to the state purchased and used them against their liability. Commissioner Hoffbeck responded that some of the credits could be sold to other companies.

Commissioner Hoffbeck advanced to slide 11: "Net Tax Credits versus Production Tax." He explained that the slide depicted current day taxes. He pointed out that the light green represented the total tax before any credits. The dark green bar indicated production tax after credits used against liability. The red bar showed production tax net of refundable credits. He added that those companies that were producing were paying taxes even in the current low price environment. He acknowledged that the low price of oil, the resulting cash flow issues, and the overall decrease in tax revenue all contributed to the state falling below zero for the total take when the credits were applied. Companies that were producing and had a tax liability would reach a floor. However, no bottom limit existed for companies that used the tax credits for exploration and development. There was a robust number of companies looking to develop. There was significant exploration occurring due to high oil prices that drove the credits. Also, the expiring credits were generating activity. Companies wanted to do the work prior to the expiration of credits.

Co-Chair Neuman commented that there were multiple reasons for the credits being used. He had a problem with the current graph. He felt that the chart looked at a single feature of the entire tax system. He added that it was a distortion of the public's perception of how the credits worked.

Commissioner Hoffbeck remarked that it had been discussed in several forms and he was hoping that the slide would not have to be discussed much in the future.

[2:52:17 PM](#)

Representative Munoz asked if the slide reflected the Cook Inlet tax credits in the total production tax. Commissioner Hoffbeck detailed that the refundable tax credits were in Cook Inlet, half of them were in Cook Inlet and half were on the North Slope. She clarified that the chart reflected the Cook Inlet versus the total tax. Commissioner Hoffbeck responded affirmatively.

Commissioner Hoffbeck skipped to slide 13: "Alaska Credit Burden will Naturally Decline." He relayed that the slide was a summary of the expiring credits. First, the carry forward annual loss credit for the North Slope would decrease from 45 percent to 35 percent in January, 2016. The credit in Cook Inlet would remain the same at 25 percent. Second, the small producer credit would stop accepting new producers in May, 2016. However, if they had production prior they could take the credit for a period of up to 9 years. The third credits to expire would be the exploration incentive credits for North Slope and Cook Inlet which end in July, 2016.

Co-Chair Neuman asked if the first two types of credits were primarily targeting producers other than the big three oil companies. Commissioner Hoffbeck responded that the first credits applied to both types of producers. The first applied to the North Slope and the second was focused on both Cook Inlet and the North Slope.

Representative Gara did not like the way Commissioner Hoffbeck referred to something as a tax credit that just varied the tax rate based on price. He wanted to know the effective tax rate for FY 14 before deductions and the non per barrel credit. He wondered about the effective tax rate on the producers that paid a tax. Commissioner Hoffbeck indicated he would provide the committee with the information. Mr. Stickel responded that he did not have the information with him but would be happy to provide it.

Co-Chair Neuman reassured the committee that the current discussion would not be the last on the topic. Further discussion would ensue. He recommended that members familiarize themselves with the credits.

Commissioner Hoffbeck wondered whether committee members had received the supplemental packet the department had sent over earlier the same day. He elaborated that included was a 9 page report that described each credit in more detail.

Co-Chair Neuman asked if Dan would be available for questions on the credits. Commissioner Hoffbeck responded that Dan would be available anytime.

^FY 16 BUDGET OVERVIEW: DEPARTMENT OF REVENUE

2:57:16 PM

Co-Chair Neuman asked to visit any of the major issues that had been previously discussed as the presentation moved along. Commissioner Hoffbeck turned the presentation over to Mr. Burnett.

JERRY BURNETT, DEPUTY COMMISSIONER, TREASURY DIVISION, DEPARTMENT OF REVENUE, introduced the PowerPoint presentation "Department of Revenue Budget Overview" (copy on file). He mentioned he would be going through the slides at a rapid pace and suggested members stop him with any question.

Mr. Burnett's reviewed slide 2: "Alaska Department of Revenue: Major Programs." He discussed each of the divisions briefly. The Tax Division collected taxes, forecasted and reported revenues, and regulated charitable gaming. The Treasury Division managed and invested state funds other than the Permanent Fund. The Permanent Fund Dividend (PFD) Division administered the PFD program, distributed the annual dividend payment to eligible Alaskans, and administered the Pick, Click, Give donation system which was doing better in the current year. Donations were up by about 15 percent from the previous year. He relayed that the last division within the department was the Child Support Services Division. The division collected and distributed child support to custodial parents and to the state for children who are in state custody.

Mr. Burnett explained the department's organizational chart on slide 3: "Alaska Department of Revenue." He highlighted the commissioner's position as well as his own position and that of the deputy commissioner's in Anchorage, Donna Keppers. He elaborated that Ms. Keppers was the lead on the Alaska Liquefied Natural Gas project. She also provided administrative oversight for the Tax Division and the criminal investigation unit. The remaining divisions fell under Mr. Burnett's administrative watch.

Mr. Burnett turned to slide 4: "Authorities and Corporations." He detailed that the commissioner oversaw four of the state's corporations. First was Alaska Housing Finance Corporation which the commissioner held a seat on the board. The corporation provided access to safe,

quality, and affordable housing. The commissioner also oversaw the Alaska Permanent Fund Corporation and held a board seat. The commissioner oversaw the Alaska Mental Health Trust. The commissioner did not hold a seat on the board. However, it was within DOR and provided a large number of administrative services for Mental Health Trust Authority. He furthered that the Alaska Municipal Bank handled financing options for capital projects. There were two half-time employees at the Alaska Municipal Bond Bank and a loan portfolio nearing \$1 billion.

Co-Chair Neuman added that all of the corporations were overseen by their own individual boards. Respectively they did not fall under the budget act. He suspected it made Mr. Burnett's job of managing them was pretty easy.

Mr. Burnett responded that the employees within the Municipal Bond Bank were also half-time treasury employees within his direct purview. He agreed with Co-Chair Neuman that the administration was done by the board and the executive director for the most part but showed up in DOR's budget.

Mr. Burnett advanced to slide 5: "Results in 2014: Department of Revenue as a Whole and Treasury Division." He relayed that in 2014 the department consolidated leases and combined public facing offices to reduce the state's billable footprint for greater long-term cost savings. The Department of Revenue also reviewed and updated all of its regulations, an ongoing process. In the Treasury Division 33 out of 36 funds managed by Treasury met or exceeded the benchmark returns in FY 14. He also reported that PERS and TRS funds returned 18.55% and 18.56% respectively as compared to 12.50% and 12.59% in FY 13. The actuarial assumption was 8 percent which the division exceeded.

Vice-Chair Saddler asked about the public facing offices. He assumed that Mr. Burnett was referring to offices open to the public. Mr. Burnett answered that public facing offices were offices where people came in with questions about child support, PFD payments or taxes.

Vice-Chair Saddler asked about the locations of the public facing offices. Mr. Burnett answered that the main office in Anchorage was in the Atwood Building and in Juneau in the State Office Building. The state had satellite offices

in other places, but the department was trying to consolidate them together.

Co-Chair Neuman noted that the Department of Administration was consolidating with its office saving space plan.

Mr. Burnett discussed slide 6: "Results in 2014: Tax Division." He informed the committee that the department was continuing the implementation of the Tax Revenue Management System (TRMS). Phase 1 of the system rolled out in April of 2014 for all corporate income and excise tax filers. The project included online filing options for all taxpayers. The first part of the oil and gas property tax came online in 2014. Phase 2 of the TRMS rolled out in January of 2014 for oil and gas production tax. He reported that the prior year's tax payments were uploaded to the new system which would greatly assist with auditing information and preparing statistical work. It would also be much easier to file online. He believed the system would be improved for all users. He suggested that 98.5% of known taxpayers filed tax returns and made their payments timely.

[3:05:04 PM](#)

Mr. Burnett addressed slide 7: "Results in 2014: Permanent Fund Dividend Division (PFD)." He relayed that the division contacted over 90 percent of the state's eligibility cases by the time the dividend amount was announced. He felt the division was doing a better job of getting things dealt with prior to people contacting the division. The division succeeded in reaching the highest case closure rate since 2008. PFD technicians were increasing their interactions with the public through phone, email, and in-person than the prior year. The division had changed processes over the previous several years which had made it a much better experience for the public. The division focused on improving communications with other state agencies that directly affected the Permanent Fund Dividend processes and customer service experience. He added the necessity of a collaborative effort between the division and agencies like myAlaska (ETS), DMV, and Vital Statistics. In 2014 at the beginning of the filing season there were a number of people whose names did not match between what was on file with DMV and the PFD system preventing applicants from completing an online signature. He believed it was much improved although additional improvements still needed to be made.

Representative Gara relayed his own experience when he had not received a PFD a couple of years earlier. He discussed a frustrating experience dealing with the division in the application process. Mr. Burnett replied that the division was working on the phone queue. He elaborated that the system had a feature where a caller could leave the queue and a person from the division would call back. There were other features incorporated to avoid such issues.

Co-Chair Neuman noted that committee members had all had constituents who experienced issues with the PFD system.

Representative Gara just wanted to know if the system was working. Mr. Burnett relayed that the PFD Division could often times determine whether someone tried to apply online. The system would be able to track a person attempted to apply online. If a person contacted the division and it was determined that they tried to file their application would be accepted. However, waiting two years to contact the division after the fact would be considered too late.

[3:09:04 PM](#)

Co-Chair Neuman thought there had been a change in regulation that went back to a one time mulligan where someone thought they mailed their application in, but did not, and would get another opportunity.

Representative Gara interjected that he would get to the point in the phone system where he would be able to leave a message for someone to call him back and the system would hang up. He wondered if the problem he had experienced had been resolved. Mr. Burnett believed so.

Co-Chair Neuman recommended Representative Gara contact Mr. Burnett.

Co-Chair Thompson noted that he had had a problem two years prior with his PFD. He simply walked across the street, talked with someone at the counter, and the matter was resolved.

Representative Gara was not concerned with himself but cared about the phone hanging up on constituents. Mr. Burnett responded, "And so do we."

Mr. Burnett referred to slide 8: "Results in 2014: Child Support Services Division." He conveyed that the division computed statistics for the federal government each year on child support. He pointed out the efficiency rate of the division, meeting minimum standards required to receive federal incentive payments.

Co-Chair Neuman commented that it was important information to look at because of the people it affected. He mentioned a previous audit that determined the department was efficient. He acknowledged a human factor.

Mr. Burnett advanced to slide 9: "Look Back at Department Activities." He reported that in FY 15 the department was collecting more revenues than in FY 05. A number of new programs had been added since then. There had also been many changes to the oil and gas production tax. The funds that were under management of the Treasury Division had grown from \$20 billion ten years previously to currently over \$50 billion. In the prior 2 years the Treasury Division had had more money than the Permanent Fund most of the time. It may end in the current year with spending. The number of dividends paid had increased, the Pick, Click, and Give Program was implemented, and the department was dispersing more money in child support.

Representative Wilson asked where audits fit into the picture. Mr. Burnett responded that there was a statutory framework in which audit activity within the Tax Division had to be completed. Some of the audit activities had been down over the last couple of years due to installation and start-up of the TRMS. In many cases, 35 percent to 50 percent of staff time had been spent changing systems. Now that the system was online the staff time could be designated to regular business. He understood the seriousness of Representative Wilson's question.

Representative Wilson asked what year the department was auditing currently. Mr. Burnett responded approximately 2008.

Representative Wilson commented that the state really was not caught up at all. Commissioner Hoffbeck stated that there were two contributing components; the new system, and the fact that the PPT audits were completed.

Representative Wilson relayed that although the audits were not completed it did not mean that the companies had not paid their taxes. An audit was a check to see whether the state agreed with the companies on their tax liability. Commissioner Hoffbeck responded affirmatively.

Co-Chair Neuman commented that pressure had been applied to the department to stay as current as possible with the audits.

Vice-Chair Saddler asked about the complexity of the tax audits for ACES versus other structures. He also had a question about PFD payments which he would get to. Commissioner Hoffbeck deferred to Mr. Dees. He relayed Vice-Chair Saddler's question.

LENNIE DEES, AUDIT MASTER, TAX DIVISION, DEPARTMENT OF REVENUE (via teleconference), responded that ACES and PPT were both net tax systems. He commented that they were very similar. Some changes were made in ACES that added some complexity to the audits such as the reasonable cost for transportation. The department determined what was to be a tariff for certain pipelines owned by some of the producers. Another complexity was looking at maintenance costs completed having to do with the problems that occurred in 2006 at Prudhoe Bay. He continued that the most complex portion of the audit was the audit of lease expenditures. One of the challenges was the amount of activity the auditors had to look at as well as the challenge of not having the data presented in a consistent manner. He suggested that with the new TMRS the department would be able to collect data on a more consistent basis having a data warehouse of information for the auditors to look at. Also, he mentioned the learning curve moving from a gross to a net tax system for the auditors in terms of understanding the operations of the industry.

Co-Chair Neuman stopped Mr. Dees from continuing and thanked him for his input. He mentioned other complexities.

Mr. Burnett continued with slide 10: "Department of Revenue's Share of Total Agency Operations (GF Only)(\$ Thousands)." He provided DOR's budget as it related to total agency operations and gave some historical information since 2007. He drew attention to the box to the left of the graph. He pointed out there was an error. He stated that where it said, "decreased" it should have said

"increased." It was an error on the slide. The department's operating budget was .61 percent of the state's GF budget.

Mr. Burnett scrolled to slide 11: "Appropriations within the Department of Revenue (GF Only) (\$ Thousands)." He explained that the slide showed the division detail. He added that the taxation and treasury category included the Tax Division, the Treasury Division, and the Permanent Fund Division which was why the category appeared much larger than any of the other division categories.

Mr. Burnett continued to 12: "Appropriations within the Department of Revenue (All Funds) (\$ Thousands)." He pointed out that the slide depicted "All Funds."

Mr. Burnett discussed slide 13: "Department of Revenue FY 2016 Governor's Budget by Fund Source." He commented that the largest fund source was the Permanent Fund's corporate receipts which was in the Permanent Fund Corporation's operating budget primarily used to pay management fees for its investments. The pension funds were similar. Federal funds were primarily in the Child Support Services and the Alaska Housing components. The GF was only 8 percent of DOR's total budget.

[3:20:15 PM](#)

Mr. Burnett turned to the pie chart in slide 14: "Department of Revenue FY 2016 Governor's Budget by Program." The chart reflected that the Permanent Fund was the largest portion, which funded the external manager of the state's investments. The pension fund portion of the department's budget was significant for the same reason; a large amount of money was being handled.

Mr. Burnett discussed slide 15: "Key FY 2016 Budget Changes." He reviewed that non-personal services reductions totaled about \$1.7 million undesignated general funds (UGF), personal services reductions equaled about \$1.5 million UGF, and health insurance and working reserve reductions were taken out of the budget as part of the payroll administration reductions. He reported that positions were being added in the Permanent Fund Corporation and in the Treasury Division. These positions would be paid for by reducing external management fees resulting in a net savings.

Vice-Chair Saddler asked if DOR was adding a thousand positions. Mr. Burnett responded that it was \$1 million dollars-worth of positions. Mr. Burnett continued to elaborate that the reductions in non-personal services included a reduction in federal funds because of the matched funding requirements. Some of the reductions were pension fund and Permanent Fund Corporate management fee reductions. He relayed that more detailed information would be released the following week.

Mr. Burnett reviewed slide 16: "FY 2016 Capital." He confirmed that 100 percent of the department's capital budget fell under the Alaska Housing Finance Corporation budget. The budget was small relative to previous years. He read from a list of projects:

- \$8.1 million Weatherization
- \$4.69 million Teacher, Health, Public Safety and VPSO Housing Loans
- \$4.5 million Housing & Urban Development Fed HOME Grant
- \$3 million Home Energy Rebate
- \$2.5 million Housing & Urban Development Capital Fund Program
- \$1 million Cold Climate Housing Research Center (CCHRC)

Mr. Burnett noted that the funding equated to \$17 million in UGF and \$11.5 million in federal funds.

[3:23:02 PM](#)

Mr. Burnett talked about the final slide 17: "Wrap-up." The Tax Division was actively engaged in improving its information system and improving its efficiencies. He thought there would be efficiencies in future budgets and more timely audits. The department was the state's largest investment manager and had made prudent investments over the previous several years. Department of Revenue also had achieved and maintained the highest credit rating and the lowest cost of borrowing. He reported that the department would be doing some GF refunding bonds and some bond anticipation notes in the future.

Mr. Burnett continued that the department had worked diligently to improve the customer service sections in the

PFD and Child Support Services Divisions. He suggested doing a comparison of customer support from the past to the present. He thought the improvements made an incredible success story. He also relayed that DOR's corporations had received national recognition for exemplary program management and fiscal solvency. He concluded his presentation.

Representative Munoz asked about the graph on page 10. She believed it showed a \$13 million reduction. She mentioned that the figure did not match the amount shown on slide 15. She asked Mr. Burnett to explain the differences. Mr. Burnett answered that there was a one-time item included. He would provide additional information to the committee at a later time.

Representative Munoz wondered about which divisions were affected by the personal services reductions in UGF. Mr. Burnett responded that the GF personnel costs were in the Tax Division, the Treasury Division, the Child Support Division, administrative services, and the commissioner's office.

Representative Gara reported that he would be testing out the customer service of the PFD office.

Co-Chair Thompson asked jokingly for a report back from Representative Gara.

Co-Chair Neuman thanked the presenters and reviewed the agenda for the following day.

ADJOURNMENT

3:26:56 PM

The meeting was adjourned at 3:26 p.m.